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SUBJECT: ECONOMIC EXPANSION BEGINNING TO REDUCE POVERTY

1.(U) Summary: The Instituto Nacional de Estadística e Informática (INEI), Peru's equivalent of the U.S. Census Bureau, released a study showing that poverty in Peru declined from 54.3% to 51.6% between 2001 and 2004. Although the drop in poverty was small, only 5% or 2.7 percentage points, it came as welcome news to the Toledo Administration, whose generally sound economic policies have spurred steady economic growth, but, until now, have been unable to show that the benefits have been reaching the segment of the population most in need. We are struck by how this study validates the success of the USG's approach to poverty reduction in Peru. The provinces that experienced dramatic reductions are those that have experienced expansion of export industries under ATPDEA and those targeted by USAID market-based development programs. Poverty reduction will likely continue, as the economic expansion that has gone on for more than 50 consecutive months is expected to persist for the next several years. However, local economists and the GOP believe that the economy needs to grow at 6% or higher for an extended period before Peru will see Chile-like poverty reduction. End Summary.

Poverty Report

2.(U) Peru's Census Bureau equivalent, INEI, released on October 24 the results of its four-year study of poverty, which found that poverty in Peru has declined 2.7 percentage points, from 54.3% to 51.6%. This represents an overall decline in poverty of 5%. The level of reduction varied from region to region. Two departments saw dramatic reductions. Lima, on the other hand, saw its poverty rate increase. Analysts have only begun to study the data to determine the causes for the decreases and increases.

3.(U) Nearly 70,000 interviews were conducted during the course of the survey, with more than 19,000 three-hour home interviews taking place in 2004. INEI used a poverty index based on the amount of calories consumed. The overall margin of error was 2.8%, but the margin varies region-by-region, depending on the sample size.

Booming Economy Starts to Trickle

4. (U) Since mid-2001, Peru's economy has grown about 4.5% annually, and growth in 2005 will be close to 6%. The expansion has been broad based. Construction, personal consumption and private investment are up. Exports have more than doubled, driven in part by record high mineral and trade preferences provided by the Andean Trade Promotion and Drug Enforcement Act (ATPDEA).

5.(U) The economic expansion and resulting poverty reduction have occurred mostly in areas outside Lima. The coastal areas are experiencing a mini-agricultural boom. The asparagus industry, a primary ATPDEA beneficiary and located mostly in Ica, Lambayeque and La Libertad, exported \$235 million in 2004. Poverty declined in those regions by 37%, 28% and 9.2%, respectively.

6.(U) The regions along the sierra are starting to experience a spillover effect from the agricultural boom on the coast, as the agro-industry looks for more arable land. Poverty reduction in those regions should pick up as exports of products such as paprika, papaya, melons, onions and artichoke, where USAID also has played a fundamental role, begin to accelerate. The expected growth and resulting poverty reduction will depend on either continued ATPDEA preferences or entering into force of the free trade agreement. The study found that rural poverty declined from 77.1% to 72.5%.

Growth Leaders: Mining/Energy and Apparel

7.(U) The boom in Peru's mining and hydrocarbon industries,

which has seen both the value and volume of its exports rise, is taking place entirely outside of Lima. In Cusco, the leading destination for Peru's booming tourism industry and home of the large, controversial Camisea natural gas project, poverty dropped by 18%, from 72.7% to 59.2%. Cusco and the other regions with mining and energy projects will get a large boost in the near future when the central government begins distributing the royalty tax revenues generated by the projects. Royalty funds distribution has been held up because of the lack of capacity in the regions to administer the funds. Once the funds begin to flow, some regions may see as much as \$100 million annually.

8.(U) The textile and apparel industry, which is primarily located around Lima, has seen its exports more than double since ATPDEA came into effect. ATPDEA allowed Peru to maintain its share of the U.S. market despite the removal of textile quotas and the subsequent surge in Chinese exports. Despite the success of the textile industry, Lima was one of the few departments where poverty actually increased, from 31.8% to 36.6%. INEI noted that the poverty rate is likely to decline this year due to the continued economic expansion.

Two Regions Cut Poverty in Half, Others Lose Ground

9.(U) The study found that poverty was reduced by more than half in two districts, Madre de Dios in the jungle and Tumbes on the far north coast. According to the report, these two remote regions now have the lowest poverty rates in the country. The cause of the dramatic reductions is unclear. The city of Madre de Dios has emerged as a second-tier tourist destination -- but that is not likely to account for a dramatic reduction in poverty -- and the surrounding area supports a large and often illegal logging industry. It seems most likely that a very low sample size led to an inaccurate estimation. Tumbes may have benefited from several conditions; demilitarization along the border and the subsequent bi-national development projects; favorable terms of trade created when Ecuador dollarized; and an overall increase in exports.

10.(U) Besides Lima, three other areas saw poverty increase; the southeastern region of Puno, where poverty increased from 77.3% to 79.2%; the southern region of Moquegua, which saw an increase from 28.5% to 37.2%; and Hunuco, where poverty increased from 76.6% to 77.6%. Huancavelica remains Peru's poorest region. Poverty there inched down from 86% to 84.4%.

The Gap Closes

11.(U) With poverty declining in many of the provinces but rising in Lima, the poverty gap between the provincial cities and Lima was cut by more than half, from 18% to 6%. The emerging economic rise of the provincial cities may help stem migration to Lima, which in turn could lead to poverty reduction in the capital. Overall, urban poverty declined 14%, while rural poverty declined 6%.

USAID Efforts Paying Off

12.(U) USAID's bilateral assistance program has played a pivotal role in Peru's success in reducing the poverty gap. From employment generation and business development to microfinance and food security, USAID interventions traditionally focus in some of the most poverty-stricken areas of the jungle and highlands in Peru. USAID's Poverty Reduction and Alleviation (PRA) project has generated over 18,500 new jobs and more than \$88 million in new sales over the last four years. Most importantly, USAID work opened markets for non-traditional products from those rural poor areas; those products in turn are becoming a motor for their sustainable growth. Technical support and loan capital to microfinance institutions expanded financial services to nearly 300,000 clients of whom 98% are living below the poverty line. Technical assistance and studies have influenced and helped government to focus badly needed infrastructure investments on those areas.

13.(U) Continued work in USAID assisted regions is expected to contribute to a more rapid decline of poverty during the coming years. In Cusco and Ayacucho, where poverty declined by 18% and 8.3% respectively, USAID has increased competitiveness and opened up markets for red peppers, handicrafts, ceramics, organic coffee and cacao, now the flagship crops for those regions. In San Martin and Ucayali regions, poverty has declined by 16.2% and 21% respectively. The recently completed rehabilitation of the Fernando Belaunde Terry highway, USAID's current single major investment in San Martin, will boost the regional economy, and forest concessions in Ucayali will start producing certified timber with USAID assistance.

Comment

14.(U) The Toledo Administration deserves much credit for creating the economic environment that led to sustained, broad-based economic growth and the subsequent poverty reduction. However, the 5% decrease in poverty, in the face of nearly a half-decade of solid economic growth, is less than satisfying. To harness the extra growth needed to achieve Chile-like poverty reduction, Peru is going to have to tackle some large structural problems, such as education, health and judicial reform.

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